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C O N F I D E N T I A L SECTION 01 OF 05 ABU DHABI 003526

SIPDIS

STATE PASS USTR

USTR FOR AMBASSADOR ZOELLICK FROM AMBASSADOR SISON
DEPT FOR NEA, NEA/ARP, NEA/RA, ECON, EINV, ETRP, TC

E.O. 12958: DECL: 10/04/14
TAGS: OVIP TC ETRD ECON EINV PREL
SUBJECT: SCENESETTER FOR USTR ZOELLICK'S TRAVEL TO THE UAE

REF: ABU DHABI 3410

¶1. (U) Classified by Ambassador Michele J. Sison for reasons 1.5 (b) and (d).

¶2. (C) Ambassador Zoellick: I would like to welcome you to the UAE. Your visit comes during a dynamic period in the U.S.-UAE bilateral relationship. Over the last few years, relations between the UAE and the U.S. have deepened and expanded in the military, counter-terror, and nonproliferation arenas. Senior UAEG officials want our economic links to become as close as our other ties and argue that a Free Trade Agreement would be the best way to cement this relationship.

¶3. (SBU) Coming a week after the October 4-5 TIFA meetings in Washington, your visit is an opportunity to highlight the UAE political commitment for an FTA, which the UAEG views as an economic and strategic issue. As a federation of seven emirates, the UAE is enthusiastic regarding the prospect of negotiating an FTA with the United States. At both federal and Emirate-levels, you will find the leaders to be engaged and cooperative. However, as was apparent during this week's TIFA meetings, the Ministry of Economy and Commerce stands out from the rest of the UAE government agencies and departments and has not been forward-leaning on issues such as the Arab League boycott and the companies law. Getting this ministry on board and working as a productive agent of change will be a challenge that the Emiratis must manage over the next few months. However, this Minister is not in the inner leadership circle and we expect that the Abu Dhabi and Dubai political leadership will pull him and his Ministry along.

Meetings and Interlocutors

¶4. (C) We have requested meetings for you with:

-- Crown Prince of Abu Dhabi Emirate Sheikh Khalifa bin Zayed Al-Nahyan. The eldest son of President Zayed, Crown Prince Khalifa effectively holds the purse strings for the Abu Dhabi emirate, the wealthiest and most populous of UAE's seven emirates, as well as for the federation. (Note: President Sheikh Zayed's health is precarious, and the country is on the verge of leadership succession (see reftel). End note.) Khalifa also serves as Chairman of the Abu Dhabi Executive Council, which decides which projects to fund in Abu Dhabi, Chairman of the Supreme Petroleum Council, which formulates oil policy, and Chairman of the Abu Dhabi Investment Authority, which decides how the richest emirate will invest its vast wealth. On the federal level, Khalifa is the Deputy Supreme Commander of the UAE Armed Forces. Crown Prince Khalifa will succeed Zayed, with the consensus of the other emirates. Khalifa is soft spoken and can appear as disengaged. He values the strategic relationship with the U.S.

-- Deputy Crown Prince of Abu Dhabi Emirate and UAE Armed Forces Chief of Staff Sheikh Mohammed bin Zayed Al-Nahyan (MbZ). Last November, Sheikh Zayed removed all doubt about UAE succession by appointing MbZ (the third son of the President) as Deputy Crown Prince of Abu Dhabi. As a result of this designation, MbZ would succeed Khalifa as Crown Prince. MbZ is widely regarded as a man of action and vision and as Chief of Staff of the UAE Armed Forces, he has built his power base in the UAE military and wields considerable influence over the country's military expenditures. He has also sought to build close ties with senior policy makers of the UAE's principal allies, the U.S., France, and the United Kingdom. MbZ is a key arbiter of the draft labor law, and was just appointed honorary chairman of the newly established Higher Committee for Coordination of Economic Policies, Programs and Plans of the Emirates.

-- UAE Deputy Prime Minister and Minister of State for Foreign Affairs Sheikh Hamdan bin Zayed Al-Nahyan (HbZ). HbZ, the fourth son of the President, is another ruler who shapes the political and economic landscape. As the de facto Foreign Minister since 1990, HbZ is highly capable and works to cement political and economic ties with UAE's key partners. He is a key bilateral interlocutor and proponent of an FTA. He plays a critical role in coordinating policy among the seven emirates and exerting discipline in the cabinet. He chairs the Red Crescent Authority that took lead on UAE's humanitarian assistance to Afghanistan, Iraq and Palestine.

-- Crown Prince and de-factor ruler of Dubai Emirate Sheikh Mohammed bin Rashid Al-Maktoum (MbR). MbR, the most dynamic and pro-business leader in the Emirates, is one of our most important contacts in the UAE. He is an intelligent, pragmatic, and decisive interlocutor who responds best to straight talk. MbR and MbZ have developed a good rapport over the years, and they generally cooperate closely on most federal-level decisions. MbR will play a key role in "selling" an FTA to Dubai's powerful merchant class, some of whom are expressing concern about their ability to maintain their longstanding agency relationships with U.S. companies when agency requirements are eliminated.

-- Deputy Ruler of Dubai Emirate and Minister of Finance and Industry Sheikh Hamdan bin Rashid Al-Maktoum. Sheikh Hamdan bin Rashid is the titular Finance Minister, though MinState for Finance Khirbash (a fellow Dubayyan) actually fills most aspects of the Finance Minister role for the UAE. HbR is quiet, introspective, and sometimes reclusive, but despite his deceptively low-key style, he is a savvy operator, often representing the interests of more conservative elements of Dubai society.

-- Minister of State for Finance and Industry Dr. Mohammed Khalfan bin Kharbash. Khirbash will join HbR for your meeting with him. Dr. Khirbash negotiated the TIFA with the U.S. and chaired the first TIFA Council session. He is a practical, results-oriented individual, who is particularly adept at refereeing and settling bureaucratic turf battles inherent to the loose, confederal structure of the UAE. He also appears to have the support of the ruling families of both Abu Dhabi and Dubai. He has also recently begun reaching out to Dubai's leading merchant families to help them see the advantages of an FTA.

¶5. (U) In addition to your formal meetings with government officials, we will hold roundtable discussions with influential business and community leaders in Abu Dhabi and Dubai. On the way from Abu Dhabi to Dubai, your delegation will have the opportunity for site visits at the Jebel Ali Port and Dubai Internet City. At Jebel Ali, you will receive a briefing regarding the movement of container traffic in Jebel Ali port. Sultan bin Sulayem, Executive Chairman of Dubai Ports, Customs, and Free Zone Corporation, will join you for this briefing. At Dubai Internet City, you will have a roundtable meeting with 10 to 15 senior American managers from Hewlett Packard, Oracle, Cisco, Microsoft, and Sun to discuss how an FTA could open up the rest of the UAE to U.S. investment opportunities like those currently in the free zones. Additionally, we propose a press roundtable with print and TV reporters. We are in the process of coordinating this event with Rich Mills.

Economic Synopsis

¶6. (U) The UAE has followed a market-oriented growth strategy aimed at diversifying the economy. It is the third largest economy in the Arab world, just behind Saudi Arabia and Egypt. 2003 GDP stood at $74 billion (larger than Bahrain, Qatar and Kuwait combined), with per capita GDP more than $20,000. Oil accounts for about 40 percent of the UAE's GDP, and major non-oil industries include manufacturing (11 percent), wholesale and retail trade (10 percent), government services (9.6 percent), and construction (8 percent). There are over 500 U.S. companies physically present in the UAE, and the U.S. trade surplus is significant; in 2003 the U.S. exported $3.5 billion to the UAE and imported $1.1 billion in UAE goods. With an estimated real economic growth rate this year of 5.5% to 6%, it can be a growth market for U.S. exports in goods and services rticularly in the sectors of construction/engineering, information technology, and oil and financial services.

¶7. (U) According to the National Bank of Abu Dhabi, exports are projected to have reached $56 billion while imports grew to $37 billion, giving the UAE a trade surplus of $19 billion and a current account surplus of $11 billion. Oil and gas exports made up between 40-45% of total exports in 2002 (depending on the source of the data), with major trading partners including Japan, the EU, Iran, and the U.S. Japan buys about 65% of UAE oil exports and constitutes the largest overall export market. Other major markets are India and Iran (the largest market for "re- exports"). The UAE imports almost half of its goods from Asia, and about 30% from the EU.

¶8. (U) The UAE is a member of the GCC Customs Union, which has fixed tariffs on most goods at 5% (cigarettes at 100% and alcohol at 50% are two notable exceptions). (note: The UAE needed to raise its external tariff to meet the GCC common external tariff. End note.) The UAE has benefited from its membership in the customs union. In the year since the GCC customs union was founded, the UAE's exports and re-exports increased by about 33% to about $ 1.85 billion. This total does not include the volume of transshipped goods that passed through the UAE's free trade zones. Exports and re- exports include goods manufactured

in the UAE or imported into the UAE, modified and then re-exported. The UAE's participation in the customs union was also the main contributing factor to the creation of a federal customs authority, which is slowly beginning to coordinate the efforts of the customs departments of the individual emirates. The UAE was unable to get agreement from its GCC partners to have goods produced in its free zones eligible for duty free entry to other GCC countries.

¶9. (U) There are sharp differences in the wealth of the various emirates. The Emirate of Abu Dhabi, which owns 90% of the oil and gas reserves in the UAE, is the richest emirate. In 2002, Abu Dhabi's share of total GDP was about 58%. Dubai, the commercial capital, produced the next largest share at 26.5%, followed by Sharjah at just under 10%. The four northern emirates are much poorer, have fewer resources, and fewer economic opportunities. They have been much less successful in developing their economies and are highly dependent on grants from the emirate of Abu Dhabi and the federal government.

¶10. (C) Given the decentralized decision-making structure of the UAE, different emirates have encouraged privatization and foreign direct investment (FDI) to different degrees. Many of the large industries are owned either by the federal government or by the individual emirates. The Abu Dhabi National Oil Company is a holding company owned by the emirate of Abu Dhabi, which owns the majority of oil producing assets in the emirate. Unlike most other GCC countries, however, the UAE never fully nationalized the oil sector. Foreign oil companies, including Exxon-Mobil, BP, and Total all own "upstream" oil assets. Abu Dhabi is also tendering a 28% stake in the Upper Zakkum offshore oil field. Exxon-Mobil is one of the 3 companies short-listed in the bid for the field.

¶11. (U) Abu Dhabi has begun to privatize the water and power generation sectors, which are about now 33% privately owned. U.S. companies have substantial interests in this sector. An American firm was awarded the first Independent Water and Power Project in 1988 for an estimated value of $750 million. The firm was selected as part of an Anglo-American consortium to manage a second IWPP in 2001. Unlike state-owned enterprises (SOEs) in many countries, however, the SOEs in the UAE generally are profitable. Especially in Dubai, they are traditionally given assistance to start, and then forced to compete freely in the market. According to one oft-recounted story, the chairman of Dubai-owned Emirates Airlines reportedly went to the ruler of Dubai and requested protection for the fledgling airline. The ruler replied that he couldn't do that, because he "loved the airline, but he loved Dubai more."

¶12. (U) According to the UNDP, the stock of inward FDI in the UAE is $1.4 billion, whereas the UAE is estimated to have around $3 billion in FDI overseas. UAE law limits foreign ownership of companies to 49% outside the free zones. There is no income tax in the UAE. Foreign banks pay 20% tax on profits and foreign oil companies with equity in oil concessions pay taxes and royalties on the proceeds. Companies operating in the free zones can be 100% foreign-owned, but require a local distributor if they sell products in the UAE.

Free Zones

¶13. (U) One of the ways that the UAE attracts FDI is through the free zones. Free zones are areas set aside by decree that are exempt from the UAE agency law requiring all firms to be owned at least 51% by a UAE national. Free zones are attractive to foreign investors for several reasons. First, they allow 100% foreign ownership, and, like the rest of the UAE, allow full repatriation of profits and no taxes. Second, free zones offer a one-stop shop for government services, providing assistance with

everything from incorporation to sponsoring and bringing in foreign workers. Third, firms in free zones can import and export without paying any customs duty. Next, free zones (particularly in Dubai) are managed to Western standards, with reliable energy supplies, internet access, cargo facilities, and so on. Finally, the free zones have the advantage of being synergistic clusters of related-industry firms, such as Dubai Healthcare City and Dubai Internet City.

¶14. (U) From the perspective of a company interested in DFI in the UAE, there are two main downsides to free zones. If a free zone wants to sell its products into the UAE, it must find a distributor outside the free zone. The distributor is subject to the UAE agency law, so must be at least 51% Emirati owned. The distributor basically "imports" the goods from the free zone, paying the 5% Customs tax in the process. Second, all the perks of the free zones mean that rents are significantly higher inside a free zone than out.

¶15. (U) UAE free zones have attracted approximately 5,000 companies and an estimated investment of over $ 4 billion. Dubai has led the UAE in its establishment of free zones, with about a dozen either operating or almost open. Dubai has pioneered concepts such as Dubai Internet city (for IT firms), and the Dubai International Financial Center (which hopes to set up a major regional financial center and exchange). With highly varying degrees of success, six of the UAE's seven emirates have at least one active free zone. Abu Dhabi does not have any active free zones. The oldest and largest free zone, Dubai's Jebel Ali, was established in 1985 and is home to over 2,200 companies from over 100 countries. Despite the free zones' proven ability to attract foreign direct investment, the UAE has so far not liberalized its FDI environment outside the zones. Dubai Internet City, one of the locations you will visit, houses a total of 560 companies, 80 of which are U.S. companies that employ approximately 100 U.S. employees.

Key Discussion Issues

¶16. (SBU) Labor: The current UAE Labor Law does not provide for labor unions, the right of association or collective bargaining. However, in June the UAE Cabinet approved a memo calling for the establishment of labor unions. The UAE Minister of Labor and other UAE labor officials have told us recently that the UAE is committed to moving forward on developing labor unions, but that the process will be a slow and deliberative one, with considerable debate among UAE stakeholders (including the chambers of commerce and the Emirati teachers, engineers, and lawyers associations). At present, two laws are being drafted; one that revises the existing labor code, and a new trade union law that will stipulate the details of labor unions. UAEG officials tell us that the Ministry of Justice technical committee has completed about 70 percent of the review process for the revised labor law and should complete the review within the next two months. The new trade union law is still in the drafting stage, but the UAE hopes that the law will be in effect by mid-2005.

¶17. (SBU) Our interlocutors stress that labor unions and the foreign worker population are serious issues for the UAE, and the UAEG is concerned about balancing their commitment to improving workers' rights with the security and social challenges of having a 98 percent foreign worker population in the private sector. UAEG officials recognize that inclusion of expatriates in the new laws is a key issue for the United States, and the Minister of Labor emphasized that he was not interested in having Emirati-only labor unions. A key question for the UAEG was the level and type of foreign participation that would be allowed.

¶18. (C) Arab League Boycott: Although the UAE a matter of policy longer enforces the secondary or tertiary aspects of the Arab League Boycott, U.S. companies have occasionally faced contracts in the UAE with a boycott provision. This issue has been raised with senior UAEG officials, and we believe the UAEG has the political commitment to respond positively to our concerns. There appears to be confusion on the part of some Emirati companies as to what constitutes a secondary or tertiary boycott, and in some instances, officials at the Ministry of Economy and Commerce may be using outdated forms. The Ministries of Foreign Affairs and Finance are actively working this problem and have assured us that the UAE will absolutely not boycott U.S. companies. Ministry officials realize that resolving this issue is key to proceeding forward with FTA negotiations, and they are fully engaged to ensure that it does not continue to be a problem.

¶19. (SBU) Agencies Law/Companies Law: UAE officials recognize that the existing agency law is a key area of concern for the U.S. in moving toward an FTA; however, many UAE nationals (including royal family members and prominent merchant families) profit from the agencies law requiring foreigners to contract with a UAE national in order to import or trade goods in the UAE. The elimination of this law will require active engagement by federal and Emirati-level leaders to overcome the concerns of nationals who fear they may loose their income from agency relationships. UAEG reformers would plan to use the carrot and stick of FTA negotiations with the U.S. to make changes to the agencies law and the commercial companies law (at least as they apply to U.S. firms). A senior official from the Ministry of Economy and Commerce noted that the ministry believes an open and free market benefits the nation's economy, but he acknowledged that vocal lobbies are working to protect their interests, just as they do anywhere. He opined that his government needs to convince consumers that changing the agency law is in their best interest, thus energizing them to participate in an informed debate with those advocating the status quo. During the October 4th TIFA council meetings, UAE officials noted that an additional concern on the part of the UAEG is that by allowing foreign ownership, the UAE would end up with even more foreign workers taking jobs away from UAE citizens.

¶20. (SBU) Progress is being made regarding the companies law, which limits foreign ownership of commercial entities in the UAE to 49 percent. The draft of a revised companies law includes a provision that will grant foreign companies an exception to the 51/49 percent ownership requirement, provided the foreign company meets certain criteria, such as having direct capital investment, providing a feasibility study, and guarantying to the UAEG that it will hire a significant percentage of Emirati nationals. This draft law has been in process for several years now as part of the UAE's efforts to comply with WTO investment rules. It is not clear when it will be enacted. But Ministry of Economy and Commerce officials recognize that now advance of potential FTA negotiations the most opportune time to enact this piece of legislation.

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Bilateral FTA Clear Preference Over Regional FTA
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¶21. (SBU) The GCC Secretariat's February proposal to the USG regarding initiating region-wide free trade negotiations with the United States put UAE officials in the uncomfortable position of formally having to support the GCC 'party line,' but senior UAEG officials have made it very clear that the UAE intends to pursue bilateral trade agreements with the United States, regardless of GCC initiatives. UAEG officials have said that GCC talks, which include Saudi Arabia, would "bog down" negotiations, and indeed, the GCC/EU FTA negotiations are an example of this. The GCC countries are having a difficult time reaching consensus positions regarding the liberalization of certain services sectors, and as a result, the GCC/EU

FTA negotiations have essentially stalled.

¶22. (U) I look forward to welcoming you and your team on October 12th.

SISON